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The Manufacturers Hanover Financial Digest

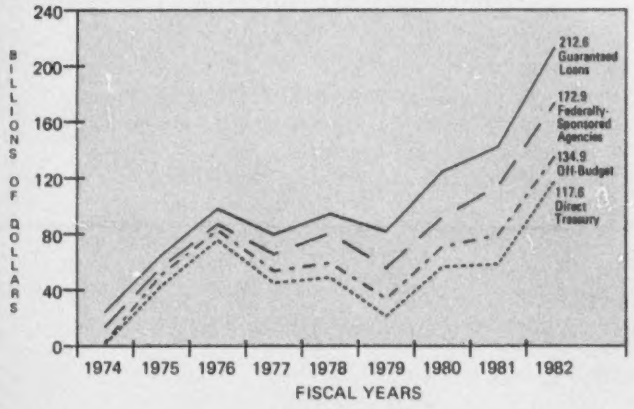
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, NOVEMBER 8, 1982 VOLUME XIX, NUMBER 45

To The Congressional Victors . . .

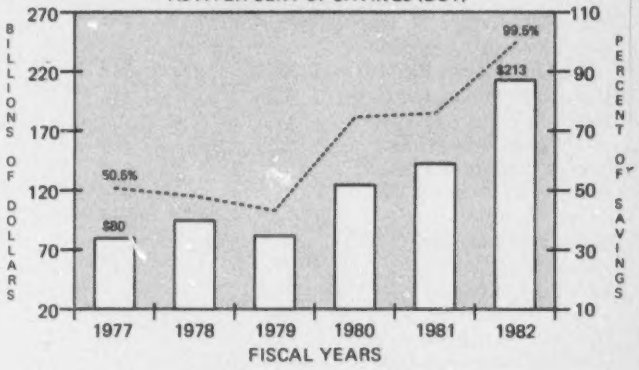
With the midterm elections now over, the debate begins as to what conclusions can be drawn from them about the current mood of the electorate, especially its attitudes toward the Administration's economic programs. Political observers have declared for months that these elections would be a referendum on "Reaganomics," but if they were, the outcome was mixed. For despite such sizable net Democratic gains as seven new governorships—five in the recession-plagued upper Midwest—and 26 House seats, the Republicans did manage to maintain their existing numerical edge in the Senate. As a result, both major parties have proclaimed a victory of sorts, declaring that the public had decided to either "stay the course" or "abandon ship." But whatever the political pundits eventually decide, there is one Capital city fixture that remains: The ballooning Federal budget deficit and its associated borrowing requirements.

CHART I
COMPONENTS OF FEDERAL BORROWING



Although the newly-elected Congress may eventually alter the thrust of fiscal policy, especially the defense/non-defense mix of public spending, there will probably be very little change over the next several months. Nor are any abrupt changes likely in the conduct of monetary policy. While it remains unclear as to whether or not the Federal Reserve did permanently abandon its adherence to monetarism, it appears a good bet that the monetary reins will not be firmed as long as the number of business bankruptcies continues to soar and the jobless ranks continue to swell. Indeed, judging by these developments, as well as recent trends in inflation, just the opposite might be needed.

CHART II
TOTAL FEDERAL BORROWING (BAR) VS.
TOTAL FEDERAL BORROWING
AS A PER CENT OF SAVINGS (DOT)



It appears that the economy has finally begun to stir—if the recent upticks in the index of leading economic indicators, factory orders, housing starts and single-family home sales have any predictive value at all. But while the long-awaited revival of business activity may now be underway, its staying power could be short-circuited by fiscal policy. For lost amidst the post-election rhetoric is one very disturbing pre-election fact: Ever-widening budget deficits and the vast Federal borrowing needs that go with them. In fiscal year 1982, the reported "on-budget" Federal deficit soared to a record $111 billion, more than $53 billion higher than fiscal year-earlier levels. Adding to this total a further $17 billion of "off-budget" outlays, primarily those of the Federal Financing Bank, yields an "enlarged" budget deficit of just a shade under $130 billion—also a new record, needless to say.

. . . Go The Spoils . . .

This massive red ink total stemmed from a combination of both dampened revenue growth and a sharp rise in Federal spending. On the one hand, the cuts in personal income tax rates in 1981, the recession and the lower rates of inflation which it caused, clearly affected receipts growth adversely. Total

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receipts rose by only 2.6 per cent in fiscal 1982 year-over-year, the smallest rise since 1975. Outlays, on the other hand, headed in the opposite direction. They increased 11 per cent year-over-year, reaching 24 per cent of GNP—their highest level, when expressed as a proportion of total output, since 1946. Spending on income security programs, especially Social Security, farm price supports and interest on the public debt all soared; these three items alone accounted for almost two-thirds of the $74 billion rise in total Federal outlays. Interestingly, the often-cited budget nemesis of increased military spending accounted for only about 35 per cent of the year-over-year outlay gain—indicating that the full impact of President Reagan's defense proposals has yet to come.

This suggests that the deep and persistent recession alone is not solely responsible for the current budget woes. To be sure, each one percentage point increase in the unemployment rate lifts the red ink total by approximately $20 billion, while a one percentage point downturn in real GNP growth raises the deficit by about $10 billion. But even reducing the unemployment rate to its year-ago level of about seven per cent and accelerating economic growth by three full percentage points in the current fiscal year would lower the deficit by no more than $90 billion. This is, indeed, a sizable improvement—but it still would leave a core budget deficit of around $70 billion. With deficits of $155-$160 billion likely this fiscal year and next, it becomes clear that the cyclical portion of the budget deficit is just one

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/27/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	141.695	– .946	+ 9.592
Loans to Depository Inst.	.452	– .063	– .732
Float	1.675	– 1.109	– 1.271
Total Reserve Bank Credit	153.721	– 2.069	+ 8.131
Treasury Deposits with Federal Reserve Banks	2.774	– .084	– .295
Currency Outside Banks	132.641	– 1.643	+ 9.359
Member Bank Reserves:			
Required	40.778	– .194	+ .132
Excess (Deficiency)	.270	– .029	+ .033
Total Reserves Held	41.048	– .223	+ .165
Net Borrowed Reserves	.092	– .039	– .708
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	100.203	– .016	+ 9.721
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1	470.2	+ 14.5‡	+ 8.0‡
M2 (September '82)	1,954.1	+ 9.7	+ 9.9
M3 (September '82)	2,362.4	+ 11.6	+ 10.5
L (June '82)	2,798.0	+ 12.0	+ 11.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 11/5/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.70%	8.20%	8.30%
* Federal Agencies	8.00	8.70	9.45
* Project Notes—Taxfree (46% Taxable Equivalent)	7.50	7.96	9.44
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	9.00	9.05	9.88

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	8.63%	Dec.	8.65%
15- 29 days	8.63	Jan.	8.70
30- 59 days	8.63	Feb.	8.70
60- 89 days	8.50	Mar.	8.75
90-179 days	8.50	Apr.	8.65
180-239 days	8.50	May	8.60
240-270 days	8.50		

‡Industrial Paper—Prime		†Federal Funds	
30- 89 days	8.40%	Effective Rate	9.35%
90-120 days	8.40		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'82	$ 3,091	$ 3,045	$ 2,981
Gross National Product (1972 Dollars)*	3rd Q'82	$ 1,481	$ 1,478	$ 1,510
Percent Change, Annual Rate	3rd Q'82	0.8	2.1	2.2
Change in Consumer Prices (all urban consumers)*	Sep '82	2.4%	3.6%	13.2%
Change in Producer Prices*	Sep '82	– 1.2%	7.2%	2.4%
Civilian Employment (Thousands of Persons)†	Oct '82n	99,093	99,720	100,343
Unemployment as % of Civilian Labor Force†	Oct '82n	10.4%	10.1%	8.0%
Personal Income*	Sep '82	$ 2,605	$ 2,597	$ 2,479
Leading Indicators Composite Index (1967=100)†	Sep '82	130.4	129.7	130.7
Industrial Production Index (1967=100) †	Sep '82	137.3	138.1	151.6
Net Change in Consumer Installment Credit†	Aug '82	$ 0.07	$ 0.57	$ 2.43
U.S. Merchandise Trade Balance †	Sep '82	–$ 4.19	–$ 7.08	–$ 2.77
Plant and Equipment Expenditures*	4th Q'82	$324.47(a)	$328.04(a)	$327.83
Private Housing Starts (Thousands of Units)*	Sep '82	1,146	1,002	899
New Construction Expenditures*	Sep '82n	$ 229.8	$ 230.2	$ 233.5
Total Business Inventories†	Aug '82	$ 515.6	$ 513.4	$ 510.1
Total Business Sales†	Aug '82	$ 339.1	$ 344.6	$ 354.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

component of the red ink total—and may soon not even be the largest. The rapid growth of inflation-indexed entitlement programs in years past, and defense spending and interest costs in years to come, is simply not compatible with the huge tax cuts already legislated.

. . . Including A Bloated Federal Deficit

As a result, the financial markets will have to wrestle with a deluge of new Treasury issues well into the future. For as the deficits spin higher, so do Treasury borrowing needs. They reached $134 billion in fiscal 1982 (including off-budget borrowings), compared with less than $80 billion in fiscal 1981. As if this was not bad enough, these borrowings are, as shown in Chart I, only one component of the Federal intrusion in the credit markets. Including the credit needs of such Federally-sponsored agencies as the Farm Credit Banks and the Federal Home Loan Banks, as well as the market impact of Federally-guaranteed loans, total Federal and related borrowings surged to more than $210 billion in fiscal 1982. This compares with total borrowings of $142 billion in fiscal 1981, and less than $80 billion just five years ago.

It also means that the Federal government, both directly and indirectly, is absorbing an ever-larger proportion of net national savings. Whereas such borrowings were equivalent to 50 per cent of net national savings in fiscal 1977, this ratio soared to just about 100 per cent in fiscal 1982. What is more,

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (10/20/82)	147,832	– 582	+19,812
New York City (10/20/82)	38,229	+ 729	+ 6,187
Commercial Paper (10/20/82)	171,861	– 1,749	+ 8,132

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/20/82)	217,854	– 750	+29,168
New York City (10/20/82)	62,005	– 509	+ 6,986

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/20/82)	502,534	– 1,098	+42,715
New York City (10/20/82)	121,709	– 423	+ 9,317

Financial Markets

	Friday 11/5/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.05%	– .05	– 4.58
180-Day Bills†	8.75	– .05	– 4.37
Longest Bills†	9.10	– .05	– 4.40
Recent Issues:			
9 3/4s 10/31/84	9.75	+ 1.96	
12 1/4s 9/30/86	10.22	– .19	
10 1/2s 11/15/92 (When Issued)	10.50	NA	
14s 11/15/11	10.64	– .23	
Municipals:			
Bond Buyer–20 Bond Index* (11/4/82)	9.96%	– .09	– 2.48
Blue List Total ($ Million)	$1,121	–$ 202	+ $ 374
30-Day Visible Supply ($ Million)	$6,316	+$2,037	+ $4,441
Total	$7,437	+$1,835	+ $4,815
Corporates:			
Moody's Aa Composite (11/4/82)	12.43%	– .42	– 2.98
30-Day Visible Supply ($ Million) ‡	$ 995	–$ 425	NA
Stocks:			
Dow-Jones Averages:			
Industrials	1051.78	+ 59.97	+ 199.33
Transportation	452.19	+ 32.00	+ 69.07
Utilities	122.55	+ 3.41	+ 15.02
65 Stocks	412.67	+ 23.64	+ 69.49
Standard and Poor's 500 Stocks	142.16	+ 8.45	+ 19.49
N.Y.S.E. Composite Index	81.83	+ 4.88	+ 10.50
N.Y.S.E. Avg. Daily Vol. for Week (000's)	112,392	+29,118	+ 58,894

* 46% Taxable equivalent 18.44%.
‡ Series redefined: Historical data not available.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/5/82	Week Ago
Overnight	9.50%	9.63%
1 month	9.50	9.63
3 month	9.69	9.94
6 month	9.75	10.19
1 year	10.13	10.50
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	12.45%	12.75%
Long Term (7 to 15 yrs.)	12.50	12.70

FOREIGN EXCHANGE SPOT RATES New York Opening (11/5/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02007	49.82
Canada	.8189	1.2212
Denmark	.1107	9.0295
France	.1377	7.2625
Germany	.3886	2.5735
Italy	.0006781	1474.50
Japan	.003619	276.35
Mexico	.008130	123.00
Netherlands	.3570	2.8008
Switzerland	.4499	2.2228
U.K.	1.6670	.5999

with the Federal deficit likely to reach $160 billion in fiscal year 1933, total borrowings will surge again—perhaps as high as $275 billion. At this level, they would absorb more net savings than the economy is likely to generate next year, and comprise a record proportion of total funds raised in the credit markets. Indeed, for the next Congress, this is one spoil that will not go away (see Chart II).

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Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, NOVEMBER 15, 1982 VOLUME XIX, NUMBER 46

There Is Some Good News . . .

Following many months of bleak economic news, a few statistics have been released in recent weeks which offer some hope that the economy is scraping bottom and may be about to turn the corner. Perhaps the most encouraging evidence comes from the housing industry, where in September, there were substantial improvements at every stage of development. Sales of finished new homes rose by almost a third compared with July, construction was started on 14.4 per cent more homes in September than in August, and applications for building permits—harbingers of future construction activity—soared by 16.9 per cent, month-over-month.

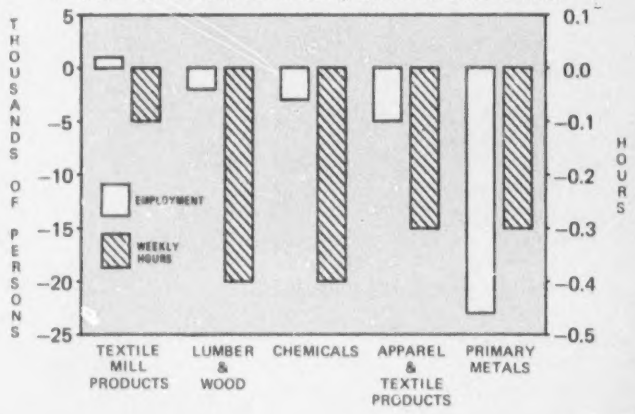
Prompted by the sharp drop in mortgage interest rates and a decline in housing prices, sales of new one-family homes advanced by almost 24 per cent in September compared with August, rising to a seasonally adjusted annual rate of 464,000—almost 40 per cent above a year ago and the highest monthly rate since May, 1981. As a result, the inventory of unsold homes fell to a relatively healthy 7.1 months at the selling rate of September, 1982; a year earlier there was almost one year's supply of unsold homes. However, many of these homes were sold at public auctions at prices significantly below those originally anticipated. Many financially squeezed builders had to generate cash to avoid bankruptcy proceedings.

. . . But The Preponderance Of Bad News . . .

But the economy needs more than one engine to pull it out of its depressed state. While September's 0.7 per cent month-over-month rise in new orders for factory goods was good news, a look beneath the surface is less cheerful. The increase was entirely attributable to a 1.5 per cent improvement in the nondurable goods category, which, despite its recent weakness, has survived this recession rather well. However, the depressed durable goods sector, which has been bearing the brunt of this recession and which desperately needs a boost, once again received fewer orders than in the preceding month.

For example, new orders for transportation equipment declined by more than ten per cent, with the dropoff centered in the aircraft and motor vehicle industries. Orders for primary metals dropped by 3.1 per cent, paced by a ten per cent drop in the demand for steel. These cutbacks were only partially offset by a pickup in orders for machinery. Orders for nonelectrical machinery rose by six per cent, while bookings for electrical machinery were up by 4.4 per cent.

EMPLOYMENT AND WEEKLY HOURS
OF PRODUCTION WORKERS IN OCTOBER
(CHANGE FROM PREVIOUS MONTH, SEASONALLY ADJUSTED)



Furthermore, although manufacturers have been working off inventories since late last year, their stocks still seem to be uncomfortably high, especially in view of the slowing shipment rate. And their backlogs are getting leaner, suggesting that they will not get any busier in the near future. All this practically insures that in the absence of a significant pickup in orders, manufacturers are not going to crank up production lines any time soon.

. . . May Again Put Off The Recovery

The downturn in economic activity and the persistence of uninspiring news have had a depressing impact on the buying habits of consumers and businessmen alike. Although retail sales adjusted for seasonal variations but not for inflation rose 0.6 per cent in October, they were still 1.4 per cent below their levels of five months ago. While most economists had expected that consumers would lead the economy out of recession, it seems that people are

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